

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 282

April 23, 1965

ESTATES: TAXABILITY OF ESTATE INCOME

Syllabus:

The taxpayer is the surviving husband of X, who died in January 1954. The wife willed her personal articles to her two daughters, and all the money in the bank to her husband. The wife made no testamentary disposition of her one-half community interest in shares of stock standing in the name of the husband, nor as to her one-sixth interest in a leasehold estate; two California residences were held in joint tenancy.

Inheritance taxes were paid to California and pursuant to subsequent examination, increased inheritance taxes were paid. After examination of the Federal return, the Internal Revenue Service proposed an estate tax deficiency on the basis of under valuation of certain properties.

It is alleged that the judge of the Superior Court ruled that it was absolutely necessary to probate the estate and included therein all community property.

Estate income tax returns were filed for the years 1954, 1955, 1956 and 1957, reporting as income to the estate the income arising from the wife's one-half share of the community property under administration during such period.

The examining agent treated the tax paid and the income arising from the wife's one-half share of the community property as an overassessment. The estate income was added to the personal income of the surviving husband on the theory that the estate was not recognized for income tax purposes. Similar adjustments to income were recommended for the year 1957, the year the final estate return was filed; however, there was no net income to the estate in 1957 since deductions exceeded reported income. The estate deficit was not transferred to the surviving husband's personal return.

Is the net income of the estate during the years in question taxable to the estate or to the surviving husband?

This problem received attention by the Legal Section when the 1950 revision of the Regulations was being drafted. It was concluded that because of the peculiar nature of the community interest of the husband in the event the wife dies first, and because of the unsettled state of the law, that the income of the wife's one-half of the community property was taxable to the estate only

where said interest was "properly" subject to administration. Thus, in each case where the wife's one-half was included in the administration of her estate a question arose as to whether it was, in whole or in part, "properly" subject to administration.

Consistent with the Federal contention we felt that normally, because title passes to survivor at decedent's death, probate in such cases was unnecessary except where the wife exercises her right to testamentary disposition by disposing of her share of the community to someone other than her husband or where it may be necessary to include her share of the community in the probate estate in order to establish proper title or community status.

The problem herein is similar to that presented in the case of Marin Caratan, 14 T.C. 932 (1950) and Edwin M. Petersen v. Com., 35 T.C. no. 107 (1961). In the Caratan case the title company required probate and the court assumed that there was a valid reason therefor. In the Petersen case probate was required since substantial outstanding contested claims were pending. Under such circumstances it would seem proper under Reg. 18101 -- 18106(a)(6) to tax one-half of the community income to the surviving husband and one-half to the deceased wife's estate. The repeated contentions, of both the Federal and State, that probate administration is entirely unnecessary have consistently been rejected by the courts as without merit. (Marin Caratan, 14 T.C. 934; Edwin M. Petersen, 35 T.C. No. 107 and the California cases cited therein.)

While Section 201 of the Probate Code provides that on the death of the wife one-half of the community property belongs to the surviving husband, Section 202 provides that the community property passing by reason of the wife's death is subject to his debts and to administration and disposal under the provision of Division 3 of this code. In Division 3, Section 300 provides that when a person dies the title to his or her property passes, among other things, to the persons who succeed to his or her estate as provided in Division 2, but that all his or her property shall be subject to the possession of the executor and to the control of the superior court for the purposes of administration, sale or other disposition under the provisions of Division 3 of this code, and shall be chargeable with the expenses of administering the estate and the payment of debts and any family allowance.

For the reasons previously assigned, it seems currently settled that the income from the one-half community interest of the deceased wife is subject to administration, hence under Reg. 18101-06(a) it is "properly subject to administration" therefore, one-half of the income from the community property is taxable to the surviving spouse and, during the period of administration, the estate of the deceased spouse is taxable on the remaining one-half of the community income.